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MEMORANDUM RECEIVED

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TO: Docket Control

FROM: Steven M. Olea
Director
Utilities Division

ARIZONA CORPORATION COMMISSION
DOCKET CONTROL

DATE: March 14, 2013

RE: IN THE MATTER OF THE APPLICATION OF VALLEY TELEPHONE COOPERATIVE, INC., AN ARIZONA CORPORATION, FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC TRANSFORMATION ORDER (DOCKET NO. T-01847A-12-0485)

Attached is the Staff Report for Valley Telephone Cooperative, Inc.'s application to increase residential rates as necessary to compensate for the rate impacts of the Federal Communications Commission's Universal Service Fund/Intercarrier Compensation ("FCC's USF/ICC") Transformation Order.

Staff recommends approval of Valley Telephone Cooperative, Inc.'s request to increase its monthly residential local exchange service rate from \$13.75 to \$14.00, effective June 1, 2013.

SMO:AFF:sms/CHH

Originator: Armando Fimbres

Arizona Corporation Commission
DOCKETED

MAR 14 2013

DOCKETED BY *LM*

SERVICE LIST FOR: VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO.: T-01847A-12-0485

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**


**VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO. T-01847A-12-0485**

**IN THE MATTER OF THE APPLICATION OF VALLEY TELEPHONE COOPERATIVE,
INC., AN ARIZONA CORPORATION, FOR A HEARING TO DETERMINE THE
EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR
RATEMAKING PURPOSES, AND TO INCREASE RESIDENTIAL RATES AS
NECESSARY TO COMPENSATE FOR THE RATE IMPACTS OF THE FCC'S USF/ICC
TRANSFORMATION ORDER**

MARCH 14, 2013

STAFF ACKNOWLEDGMENT

The Staff Report for Valley Telephone Cooperative, Inc. (Docket No. T-01847A-12-0485) was the responsibility of the Staff member listed below.

A handwritten signature in black ink, appearing to read "Armando Fimbres", written over a horizontal line.

Armando Fimbres
Executive Consultant III

**EXECUTIVE SUMMARY OF
VALLEY TELEPHONE COOPERATIVE, INC.
DOCKET NO. T-01847A-12-0485**

On December 4, 2012, Valley Telephone Cooperative, Inc. ("Valley Telephone" or "Applicant") filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission's ("FCC's") November 18, 2011, Universal Service Fund/Intercarrier Compensation ("USF/ICC") Transformation Order ("USF/ICC Order") pursuant to Arizona Revised Statute ("A.R.S.") § 40-250 and the Arizona Corporation Commission's ("Commission's") Arizona Administrative Code ("A.A.C.") R14-2-103.

Staff recommends that the Valley Telephone monthly residence local exchange rate increase from the residential local service rate of \$13.75 to \$14.00 to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the Federal Universal Service Fund ("FUSF") funds that may flow to Valley Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

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Introduction

On December 4, 2012, Valley Telephone Cooperative, Inc. (“Valley Telephone” or “Applicant”) filed an application for a determination of its earnings and the fair value of its investment and requested that its residential rates be increased to compensate for the rate impacts of the Federal Communication Commission’s (“FCC’s”) November 18, 2011, Universal Service Fund/Intercarrier Compensation (“USF/ICC”) Transformation Order (“USF/ICC Order”) pursuant to Arizona Revised Statute (“A.R.S.”) § 40-250 and the Arizona Corporation Commission’s (“Commission’s”) Arizona Administrative Code (“A.A.C.”) R14-2-103. A.A.C. R14-2-103(A)(1) requires specific financial and statistical information be filed with a request by a public service corporation doing business in Arizona for a determination of the value of the property of the corporation and of the rate of return earned. Valley Telephone submitted, as recommended by Staff, a streamlined filing in which Valley Telephone submitted the following six exhibits to support the requested increase in residential rates:

- Adjusted 2011 Results
- Adjustments
- Year 1 FCC Order ICC Impact
- Rate Base
- Working Capital
- Rate Design.

Background

Valley Telephone is a corporation duly organized and existing under and by virtue of the laws of the State of Arizona. Valley Telephone is authorized to engage in and is engaged in the conduct of a general communications business within the State of Arizona. Valley Telephone’s rates remain as set at the time of its formation and designation as an Arizona carrier.¹ Valley Telephone is a small rate-of-return (“RoR”) regulated incumbent local exchange carrier (“ILEC”).

On November 18, 2011, the FCC issued the USF/ICC Order. The USF/ICC Order transitions the outdated federal universal service programs and most intercarrier compensation systems into a new Connect America Fund (“CAF”). The FCC’s press release characterized the USF/ICC Order as “the most significant policy step ever taken to connect all Americans to broadband.”

In its USF/ICC Order, the FCC stated that it will reduce intercarrier compensation rates to zero by July 1, 2020, for RoR companies, with limited recovery from customers and partial recovery from the CAF. The recovery from the CAF will phase out over time at 5 percent

¹ Valley Telephone Cooperative, Inc. was established in 1962.

annually. The USF/ICC Order adds new rules that will reduce federal high-cost loop support ("FHCLS") to carriers by the amount their flat-rate single line residential local service rates fall below a specified local service rate floor. The rate floor includes state subscriber line charges, state universal service fees, and mandatory extended area service charges, if any are assessed. The FCC's order establishes single line residential local service rate floors of \$10.00 as of June 1, 2012, \$14.00 as of June 1, 2013, with the floor thereafter being determined annually by the FCC's Wireline Competition Bureau, based on a nationwide average.

To maintain FHCLS, Valley Telephone and other rural ILECs must increase single residential local rates to the FCC-mandated residential rate floors. Otherwise, the amount of FHCLS funds will be reduced dollar-for-dollar for each customer by the difference between the existing single line residential local rate and the new rate floor. If single line residential local rates are not increased, the new FCC rules will reduce FHCLS for Valley Telephone and other applicable ILECs. Valley Telephone's current weighted average residential local service rate of \$13.75 is above the \$10.00 rate floor. Therefore, with this application, Valley Telephone only seeks Commission approval to raise its residence local service rate to the rate floor of \$14.00 by June 1, 2013.

Consumer Services

On December 12, 2012, the Commission's Corporations Division responded that Valley Telephone is in Good Standing. A review of Consumer Services database revealed that four complaints, inquiries and opinions were received pertaining to Valley Telephone for the period January 1, 2009-December 12, 2012. All four issues were addressed successfully and in a timely manner. The files are closed.

Compliance

A check of the Utilities Division Compliance Section database showed that Valley Telephone is in compliance with all items.

Operating Income Statement

Valley Telephone submitted Regulated 2011 Results of Operations information in its streamlined filing. The submitted information was accepted without adjustment for the purposes of this streamlined application.

Operating Revenue and Expenses

According to the information provided by the Applicant, Valley Telephone Total Intrastate Operating Revenues for 2011 were \$4,533,525. Subcategories of Total Intrastate Operating Revenues are noted below:

Local	\$582,479
USF-HCL2 & Safety Net	\$3,478,458
Access Revenues	\$399,506
Other	\$73,082

The Company also provided information that stated that its Total Intrastate Operating Expenses for 2011 were \$4,318,913. Subcategories of Total Intrastate Operating Expenses are noted below:

Plant Expenses	\$ 1,141,014
Depreciation & Amortization	\$1,778,126
Customer Operations	\$341,755
Corporate Operations	\$702,110
Other	\$355,908

Operating Income

As provided by the Applicant, Valley Telephone Total Intrastate Operating Income for 2011 was \$214,612 before taxes and \$214,612 after taxes.

Rate Base

According to Valley Telephone, its rate base is \$30,718,283, as stated in the table below:

² Universal Service Fund – High Cost Fund

Valley Telephone

Rate Base

As of December 31, 2011

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 60,621,868	\$ 23,839,582	\$ 20,782,285
Accumulated Depreciation	(29,680,813)	(11,609,635)	(18,071,178)
Net Plant in Service	\$ 30,941,055	\$ 12,229,947	\$ 18,711,107
Plant Under Construction	295,207	116,090	179,117
Material & Supplies	510,485	158,118	352,368
Deferred Income Taxes	0	0	0
Customer Deposits	(11,947)	(4,698)	(7,249)
Other Long Term Liabilities	(1,231,887)	(526,572)	705,315
Cash Working Capital	215,370	91,999	123,371
Rate Base	\$ 30,718,283	\$ 12,064,884	\$ 18,653,398

Customer Base

Valley Telephone reported 1,780 residential lines and 464 business lines in its April 15, 2012 Utilities Annual Report.

Revenue Requirement

As stated above, the Applicant's filing was based on a streamlined basis and rates will not be set based on rate of return regulation. Therefore, the Applicant's filing does not contemplate rate adjustments based on revenue requirement analysis.

Rate Design

The Applicant did not propose a rate design as required by R14-2-103. The Applicant is seeking to increase its residential local exchange service rate by \$0.25. The Applicant's filing only contemplates changes to residence local exchange rates to compensate for the rate impacts of the FCC's USF/ICC order. With this filing, Staff will only address the monthly increase of all residence local exchange service rates to \$14.00.

Staff Analysis

Staff did not perform a regulatory audit of the information submitted by Valley Telephone. However, Staff reviewed the information filed in the context of the FCC's November 18, 2011 USF/ICC Order which is intended to transition the outdated federal universal service programs and most intercarrier compensation systems into a new CAF.

Staff has analyzed this application in terms of whether there were fair value implications. For the purposes of this matter the Applicant stipulated to the use of original cost less depreciation as the basis for a determination of its fair value rate base. The Applicant states that its intrastate rate base is \$18,653,398. The Applicant provided information that indicates that its Total Intrastate Operating Revenue for 2011 was \$4,533,525. According to the Applicant, the annual revenue effect of the increase in local telephone service rates to \$14.00 is \$5,245. Compared to the Applicant's total revenues, any revenue impact from this rate increase would be small and the impact on the Applicant's return on fair value rate base would be de minimus.

Staff's Recommendations

Staff recommends that the Valley Telephone monthly residence local exchange rate increase from the residential local service rate of \$13.75 to \$14.00, beginning June 1, 2013, to address the impact of the FCC's USF/ICC Order. Staff believes the proposed increase is just, fair and reasonable for the following reasons:

- The increase is necessitated by the FCC's November 18, 2011 USF/ICC Order;
- The increase is necessary to preserve the entirety of the FUSF funds that may flow to Valley Telephone pursuant to the FCC's rules;
- The increase will minimize/reduce the amount of future rate increase; and
- The increase will allow the Applicant to receive matching funds from the FUSF.

Staff has reviewed the rate application and the federal rule changes that have prompted the rate application. Staff concludes that the costs appear reasonable and appropriate under the unique circumstances of this case. However, Staff's recommendation in these unique circumstances should not be viewed as precedent for the processing of future rate case applications.